

1 ROBERT M. SCHWARTZ (S.B. #117166)  
2 O'MELVENY & MYERS LLP  
3 1999 Avenue of the Stars, 7th Floor  
4 Los Angeles, CA 90067-6035  
5 Telephone: (310) 553-6700  
6 Facsimile: (310) 246-6779  
7 Email: rschwartz@omm.com

8 MARCUS S. QUINTANILLA (S.B. #205994)  
9 ANDREW H. HALL (S.B. #240186)  
10 O'MELVENY & MYERS LLP  
11 610 Newport Center Drive, 17th Floor  
12 Newport Beach, CA 92660-6429  
13 Telephone: (949) 760-9600  
14 Facsimile: (949) 823-6994  
15 Email: mquintanilla@omm.com  
16 Email: ahall@omm.com

17 Attorneys for Plaintiff  
18 LA Fitness International, LLC

19  
20 **UNITED STATES DISTRICT COURT**  
21  
22 **CENTRAL DISTRICT OF CALIFORNIA**  
23  
24 **SOUTHERN DIVISION**

25  
26  
27 LA FITNESS INTERNATIONAL,  
28 LLC, a California Limited Liability  
Company,

29 Plaintiff,  
30  
31 v.  
32  
33 SEGONE, INC., a Delaware  
34 corporation,

35  
36 Defendant.

37 Case No. SACV06-423 DOC (RCx)

38 **FIRST AMENDED COMPLAINT FOR:**

39  
40 **(1) DECLARATORY RELIEF;**  
41  
42 **(2) BREACH OF WARRANTY;**  
43  
44 **(3) RESCISSION; and**  
45  
46 **(4) NEGLIGENT  
47 MISREPRESENTATION**

48 **DEMAND FOR JURY TRIAL**

49 Complaint Filed: April 7, 2005  
50 Judge: Hon. David O. Carter  
51 Dept.: 17  
52 Trial Date: None Set

1 Plaintiff, LA Fitness International, LLC ("LA Fitness"), for its claims  
 2 for relief against defendant segOne, Inc. ("segOne"), alleges as follows:

3 **JURISDICTION AND VENUE**

4 1. Defendant segOne removed this case from the California  
 5 Superior Court for the County of Orange, pursuant to 28 U.S.C. § 1441. Because  
 6 the Orange County Superior Court is located within the Southern Division of the  
 7 Central District of California, removal to the Central District was proper under 28  
 8 U.S.C. § 1441(a).

9 2. This Court has subject-matter jurisdiction under 28 U.S.C. §  
 10 1332 because this dispute involves citizens of different states. LA Fitness is a  
 11 limited liability company formed under the laws of the State of California, having  
 12 its principal place of business in California, and LA Fitness is informed and  
 13 believes and, on that basis, alleges that segOne is a Delaware Corporation with its  
 14 principal place of business in the State of New Jersey.

15 3. This Court has subject-matter jurisdiction of this diversity action  
 16 because the amount in controversy exceeds \$75,000. LA Fitness is seeking  
 17 rescission of a contract which has a value, if performed, in excess of \$75,000, and  
 18 the likely injury to LA Fitness if the contract were to be performed exceeds  
 19 \$75,000. *See Jackson v. American Bar Ass'n*, 538 F.2d 829, 831 (9th Cir. 1976).

20 **NATURE OF ACTION AND RELIEF SOUGHT**

21 4. This lawsuit arises because, three months ago, Defendant  
 22 segOne misled Plaintiff LA Fitness into signing an illegal and unenforceable  
 23 contract. The parties refer to it as the "segOne LS Equipment Placement  
 24 Agreement" (the "segOne Contract").<sup>1</sup> To induce LA Fitness to sign it, segOne  
 25 convinced LA Fitness that its television ad substitution business is legitimate when,  
 26 in reality, it is merely a clever way to make money by engaging in copyright  
 27 infringement, inducement to breach third party contracts, misappropriation, unfair

28 <sup>1</sup> A true and correct copy of the segOne Contract is attached hereto as Exhibit A.

1 competition, and other torts against television broadcasters and content providers.  
2 LA Fitness wants no part of such a business. To remain free of liability to third  
3 parties, to avoid being forced by segOne to engage in any unlawful activity, and to  
4 be made whole for segOne's misrepresentations, LA Fitness has filed this action.

5       5. The subject of the parties' contract is segOne's technology,  
6 which detects and then replaces the television commercials that normally appear  
7 while watching television with commercials that segOne inserts into the signal  
8 carried to the television set. segOne sells that "displaced" commercial time to third  
9 parties. Last year, it approached LA Fitness and offered to install its systems in the  
10 more than 140 LA Fitness facilities around the country so that segOne could sell  
11 advertising time to third parties who wanted to reach LA Fitness's highly desirable  
12 clientele—more than one million members who make more than five million club  
13 visits per month and who often watch television during their workouts. segOne  
14 anticipated collecting millions of dollars from such advertisers. It proposed to share  
15 with LA Fitness some of the revenue it generated from the sale of such  
16 "substituted" commercials. segOne assured LA Fitness that the technology's use  
17 was and would be lawful and would not violate the contract or other rights of any  
18 third parties, including DirecTV—the party from whom LA Fitness obtains  
19 television programming at each of its clubs.

20       6. To persuade LA Fitness that segOne's business was legitimate,  
21 segOne claimed, among other things, that it had entered into similar contracts with  
22 other establishments nationwide, without any objection from the broadcasters and  
23 content providers whose commercials were displaced. Further, segOne repeatedly  
24 assured LA Fitness that the arrangement would not violate any third party rights or  
25 place LA Fitness in breach of any third party obligations.

26       7. Before allowing segOne to install its devices, LA Fitness  
27 contacted DirecTV to confirm that it had no objection to segOne's ad-substitution  
28 business. DirecTV's response—received just over one month ago—was an

1 unequivocal denial of segOne's representations. Contrary to segOne's  
2 representations about the lawfulness of its business, DirecTV stated that segOne's  
3 ad-substitution scheme would violate LA Fitness's "Commercial Viewing  
4 Agreement" with DirecTV (the "Commercial Viewing Agreement"),<sup>2</sup> and any such  
5 violation would give DirecTV the immediate right to terminate all television  
6 services at LA Fitness's workout facilities and would expose LA Fitness to liability  
7 for any third-party claims—*e.g.*, copyright and related claims by the networks  
8 whose broadcasts DirecTV distributes.<sup>3</sup> The hundreds of television screens at all of  
9 the LA Fitness locations would go dark. LA Fitness's customers would be left  
10 without a health club staple to engage them during their exercise routines. The  
11 potential loss of customer goodwill and revenue would be enormous, and well  
12 beyond anything a company of segOne's size could make whole.

13       8. In view of the claims articulated by DirecTV, segOne has  
14 already breached its warranties to LA Fitness. LA Fitness has attempted to  
15 persuade segOne to rescind the transaction. Rather than voluntarily cancel the  
16 unlawful agreement, however, segOne has demanded that LA Fitness perform the  
17 contract in disregard of the rights of LA Fitness and the affected third parties.

18       9. Accordingly, LA Fitness now seeks a declaration that the  
19 segOne contract is void and unenforceable. Furthermore, LA Fitness seeks to  
20 rescind the contract and to recover the damages caused by segOne's breach of  
21 warranty and negligent misrepresentations.

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26  
27       <sup>2</sup> A true and correct copy of the Commercial Viewing Agreement is attached as Exhibit B.

28       <sup>3</sup> A true and correct copy of DirecTV's written statement is attached as Exhibit C.  
NB1:681443.2

## THE PARTIES

10. At all relevant times mentioned herein, LA Fitness was and is a limited liability company duly organized and existing under the laws of the State of California with its principal place of business in the County of Orange, State of California. LA Fitness owns and operates more than 140 health and exercise clubs in California and seven other states. It has more than one million active members who visit the clubs more than five million times each month.

11. LA Fitness is informed and believes and, on that basis, alleges that Defendant segOne is a company organized under the laws of the State of Delaware with its principal place of business in the State of New Jersey. LA Fitness is further informed and believes and, on that basis, alleges that segOne is engaged in the business of selling televised advertising and then contracting with third parties to disseminate that advertising to consumers through televisions located on those third parties' premises. LA Fitness is further informed and believes and, on that basis, alleges that segOne is authorized to do and is doing business in the County of Orange, State of California.

## **GENERAL ALLEGATIONS**

12. On or about March 3, 2004, LA Fitness entered into a written "Commercial Viewing Agreement" with DirecTV whereby DirecTV agreed to provide television programming services to LA Fitness's athletic facilities. LA Fitness hereby incorporates by reference the terms of the Commercial Viewing Agreement (Exhibit B hereto) as if set forth fully herein.

13. Last year, segOne approached LA Fitness with an offer to pay LA Fitness fees for the right to access its facilities, install equipment, and operate a system that would substitute or replace the television commercials normally displayed on the television sets at LA Fitness's athletic facilities with commercials that advertised the products and services of third parties who would contract with segOne, and not the broadcasters responsible for the television programming, for

1 the right to display their commercials on screen. Under that proposal, segOne  
2 would attach certain devices to LA Fitness's televisions, and those devices would  
3 "electronically sense a commercial break, change channels and play alternative  
4 advertising"—in effect, "swapping out" segOne's commercials for those included  
5 as regularly-scheduled portions of DirecTV's transmission.

6 14. During the negotiations between LA Fitness and segOne, LA  
7 Fitness asked segOne whether this activity would violate LA Fitness's contracts  
8 with DirecTV or the copyrights and other rights of DirecTV or broadcasters and  
9 other providers of television programming. segOne assured LA Fitness that its  
10 contracts had been implemented in numerous establishments nationwide without  
11 objection from broadcasters or content providers such as DirecTV or the television  
12 networks and other providers. segOne further specifically represented that its ad-  
13 substitution strategy would not violate LA Fitness's Commercial Viewing  
14 Agreement with DirecTV or any other relevant law or legal standard. In further  
15 support of these representations, segOne provided LA Fitness with an express  
16 warranty that its services would not infringe the rights of others or violate LA  
17 Fitness's Commercial Viewing Agreement with DirecTV.

18 15. Based on segOne's assurances, on or about February 1, 2006,  
19 LA Fitness entered into the segOne Contract (Exhibit A). Under the segOne  
20 Contract, in exchange for the ability to disseminate its "alternative advertising" to  
21 LA Fitness's patrons, segOne would pay LA fitness \$600 per month per site  
22 escalating to \$1000 per site after the first three months and increasing by 5 percent  
23 each year. The segOne Contract was to run for five years. LA Fitness hereby  
24 incorporates by reference the terms of the segOne Contract as if set forth fully  
25 herein.

26 16. After the execution of the segOne Contract, LA Fitness became  
27 aware that the assurances provided by segOne were unfounded. LA Fitness  
28 contacted DirecTV seeking confirmation that, as segOne had represented, DirecTV

1 would not object to the ad-substitution business embodied in the segOne Contract.  
2 Contrary to segOne's assurances, however, DirecTV informed LA Fitness that any  
3 performance under the segOne Contract would constitute a material breach of the  
4 Commercial Viewing Agreement. More specifically, on April 6, 2006, DirecTV  
5 informed LA Fitness in writing that performance of the segOne Contract "would be  
6 deemed by DirecTV to be a violation of ... the Commercial Viewing Agreement ...  
7 between DirecTV ... and ... LA Fitness" and that "[s]uch a violation, if not timely  
8 cured, provides DirecTV the contractual right to terminate the Commercial Viewing  
9 Agreement" resulting in the immediate termination of all television services at LA  
10 Fitness facilities. (See Exhibit C.) In its April 6 notice, DirecTV further indicated  
11 that it "would look to LA Fitness for indemnification in the event that [LA Fitness's  
12 performance of the segOne Contract should] result in a third-party claim against  
13 DirecTV."

14 17. Prompted by the concerns articulated in DirecTV's April 6  
15 letter, LA Fitness is informed and believes that, contrary to segOne's warranties  
16 and representations, segOne's ad-substitution strategy would require LA Fitness to  
17 breach its pre-existing contract with DirecTV, and will likely also involve  
18 violations of the copyright laws, *inter alia*, by leading to the creation of  
19 unauthorized derivative works of network programming in violation of 17 U.S.C. §  
20 106(2), by violating the public performance right under 17 U.S.C. § 106(4), and by  
21 willfully making unauthorized changes to the content of broadcast programming in  
22 violation of 17 U.S.C. § 122. LA Fitness is further informed and believes and, on  
23 that basis, alleges that segOne's ad-substitution strategy may involve systematic  
24 acts of misappropriation, unfair competition, and related torts against DirecTV  
25 and/or the broadcasters whose programming DirecTV distributes.

26 18. Based on DirecTV's objections to the transaction and LA  
27 Fitness's own concerns regarding the lawfulness of the segOne Contract, LA  
28 Fitness has offered to restore to segOne all funds segOne has paid to LA Fitness in

connection with the segOne Contract and to terminate the segOne Contract without harm to either party. Although segOne has not yet begun to install its devices at LA Fitness's facilities, it has rejected LA Fitness's offer to return the parties to their pre-contractual positions, has refused to accept the return of funds, and has insisted that the segOne contract be performed. In light of segOne's refusal to accept the return of funds, LA Fitness intends to deposit such funds in an interest bearing escrow account, with instructions to disburse such funds in accordance with the Court's instructions in this case.

19. Despite these communications, segOne maintains that the segOne Contract does not violate the Commercial Viewing Agreement or any statutory or common-law rights of any third parties. segOne has threatened to sue LA Fitness unless it proceeds with full performance of the segOne Contract and implementation of the segOne commercial substitution technology.

**FIRST CAUSE OF ACTION**

20. LA Fitness incorporates the allegations of Paragraphs 1 through 19, above, and realleges them as if set forth fully herein.

21. LA Fitness is informed and believes and, on that basis, alleges that the segOne Contract will cause and/or induce LA Fitness to breach its pre-existing contract with DirecTV to provide television content to LA Fitness facilities.

22. LA Fitness is further informed and believes and, on that basis, alleges that, by replacing the commercials provided by DirecTV and third parties such as television networks, segOne's ad-substitution technology, and the parties' performance of the segOne Contract, would result in acts of copyright infringement, misappropriation, unfair competition, and/or related torts against DirecTV and/or the broadcasters whose programming DirecTV distributes.

1           23. LA Fitness is further informed and believes and, on that basis,  
2 alleges that, in view of the contractual breaches and other violations described  
3 hereinabove, the segOne contract is illegal and void as against public policy.  
4 Additionally, because performance of the segOne contract would result in the  
5 termination of television services at LA Fitness's athletic facilities and could result  
6 in liabilities to LA Fitness that segOne could never indemnify, the contract fails for  
7 a lack of any meaningful consideration.

8           24. An actual controversy has arisen and now exists between LA  
9 Fitness and segOne concerning their respective rights and duties under the segOne  
10 Contract, in that LA Fitness contends that the contract is illegal and unenforceable  
11 and that LA Fitness therefore has no duty to perform. segOne disputes LA  
12 Fitness's contentions, asserts that the segOne Contract comports with all relevant  
13 laws, and, contrary to the written notice provided by DirecTV, denies that the  
14 segOne Contract violates the Commercial Viewing Agreement between DirecTV  
15 and LA Fitness. segOne contends that the segOne Contract is enforceable as  
16 written and should be performed by the parties.

17           25. LA Fitness desires a judicial determination and declaration of  
18 plaintiff's and defendant's respective rights and duties under the segOne Contract.  
19 Specifically, LA Fitness seeks a declaration from this Court that the segOne  
20 Contract is void and unenforceable because it is illegal, contrary to public policy,  
21 and lacking in consideration.

22           26. The declaration is necessary and appropriate at this time to  
23 determine whether or not the segOne Contract violates the Commercial Viewing  
24 Agreement between LA Fitness and DirecTV, and to determine LA Fitness's  
25 obligations under the segOne Contract. Such declaration will allow the parties to  
26 terminate the segOne Contract before segOne has begun to perform and will result  
27 in no prejudice to segOne. The declaration prayed for herein will permit LA  
28 Fitness to continue to perform its contractual, statutory, and common-law

1 obligations toward non-parties to this action.

2

3 **SECOND CAUSE OF ACTION**  
**(FOR BREACH OF WARRANTY)**

4 27. LA Fitness incorporates the allegations of Paragraphs 1 through  
5 19, above, and realleges them as if set forth fully herein.

6 28. Among the promises contained in the segOne Contract is  
7 segOne's warranty (the "Warranty") that the advertising disseminated pursuant to  
8 that contract "will be delivered free of any rightful claim of any third party for  
9 infringement of any right." Consistent with this warranty, the segOne Contract  
10 further provides that segOne "shall indemnify, defend, and hold harmless [LA  
11 Fitness] from any and all damages, costs, expenses, or liabilities incurred as a result  
12 of any such claim of infringement." segOne's promise of indemnity expressly  
13 extends to any claim by DirecTV that LA Fitness's performance of the segOne  
14 Contract constitutes a breach of the Commercial Viewing Agreement in effect  
15 between LA Fitness and DirecTV. The Warranty became part of the basis of the  
16 bargain between the parties and therefore constitutes an express warranty.

17 29. LA Fitness is informed and believes and, on that basis, alleges  
18 that segOne breached the Warranty in that the services contemplated under the  
19 segOne Contract do in fact infringe various statutory and common-law rights of  
20 third parties and will result in breach of the Commercial Viewing Agreement  
21 between LA Fitness and DirecTV. As alleged hereinabove, segOne's activities  
22 under the segOne Contract likely violate the copyrights of television networks and  
23 other television programming providers and likely infringe the rights of third  
24 parties by misappropriating the value of their television programming in order to  
25 sell commercials to segOne's customers. Because the segOne Contract gives rise to  
26 these and related claims of unfair competition, segOne has breached the Warranty  
27 provided in the segOne Contract.

1           30. LA Fitness has been forced to engage counsel in an effort to  
2 mitigate the damage that the segOne Contract has caused to LA Fitness's third-  
3 party business relationships and to prevent the infringement of the rights of third  
4 parties and the assertion by such third parties of claims against LA Fitness and  
5 segOne. Additionally LA Fitness executives have expended substantial time and  
6 effort in attempts to resolve this matter and have thereby been diverted from their  
7 ordinary duties to the detriment of LA Fitness. Accordingly, LA Fitness has  
8 incurred substantial and continuing damages as a proximate result of segOne's  
9 breach of the Warranty, and segOne is contractually obligated to indemnify LA  
10 Fitness for all such damages, in an amount to be determined at the time of trial.

**THIRD CAUSE OF ACTION**  
**(FOR RESCISSION)**

13                   31. LA Fitness incorporates the allegations of Paragraphs 1 through  
14 19, above, and realleges them as if set forth fully herein.

15                   32. LA Fitness is informed and believes and, on that basis, alleges  
16 that, if not rescinded, the segOne Contract will cause LA Fitness to suffer  
17 substantial harm and injury in that it will place LA Fitness in breach of its  
18 Commercial Viewing Agreement with DirecTV and may expose LA Fitness to  
19 statutory and common-law liability to DirecTV and other third parties.

20                   33. Rescission of the segOne Contract is appropriate insofar as LA  
21 Fitness's agreement to enter into the segOne Contract was induced by its reasonable  
22 reliance on segOne's misrepresentations regarding the legitimacy of the contract,  
23 and because, in view of the contract's illegality, the segOne Contract is not  
24 supported by any legally cognizable consideration.

25                   34. LA Fitness intends service of this First Amended Complaint to  
26 serve as notice of rescission of the SegOne contract, and hereby demands that  
27 segOne cease any preparations for or attempts to perform under the segOne  
28 Contract. LA Fitness will place all funds received by LA Fitness into an interest-

1 bearing escrow account with instructions to the escrow agent to deliver the funds,  
2 plus interest, as directed by the Court in this action.

3 **FOURTH CAUSE OF ACTION**

4 **(FOR NEGLIGENCE MISREPRESENTATION)**

5 35. LA Fitness incorporates the allegations of Paragraphs 1 through  
6 19, above, and realleges them as if set forth fully herein.

7 36. LA Fitness is informed and believes and, on that basis, alleges  
8 that segOne made certain material misrepresentations during the negotiation and up  
9 through the execution of the segOne Contract in or about February 1, 2006—  
10 namely that segOne's contracts had been widely accepted without objection from  
11 broadcasters and television content providers and that such contracts were entirely  
12 consistent with all relevant contracts and applicable laws. These representations  
13 specifically included representations that the segOne services would not violate  
14 paragraph 17(e) of the Commercial Viewing Agreement with DirecTV, and that  
15 segOne's activity under the segOne Contract would not infringe the copyrights or  
16 other statutory or common-law rights of DirecTV or other third parties. As alleged  
17 hereinabove, LA Fitness is informed and believes and, on that basis, alleges that  
18 these representations are false, and were false when made.

19 37. LA Fitness is further informed and believes and, on that basis,  
20 alleges that segOne knew or reasonably should have known that these  
21 representations were false and that segOne had no reasonable basis for believing  
22 that they were true.

23 38. LA Fitness is informed and believes and, on that basis, alleges  
24 that these misrepresentations were conveyed to LA Fitness in the course of business  
25 and for a business purpose.

26 39. LA Fitness is informed and believes and, on that basis, alleges  
27 that these misrepresentations were intended to induce LA Fitness to rely on them.

1           40. LA Fitness did not know that segOne's representations were  
 2 false but rather reasonably concluded that segOne was the entity with the most  
 3 complete and reliable knowledge of the legitimacy of its own business operations  
 4 and therefore relied on segOne's misrepresentations and was thereby induced to  
 5 enter into the segOne Contract.

6           41. LA Fitness has been damaged by its reliance on segOne's  
 7 misrepresentations in that LA Fitness has been forced to incur substantial costs, and  
 8 to expend substantial time and effort to unwind this transaction or litigate its  
 9 resolution.

10           **PRAYER FOR RELIEF**

11           WHEREFORE, LA Fitness prays for judgment against segOne as  
 12 follows:

13           1. For a declaration that the segOne Contract is void and  
 14 unenforceable and that the parties have no further rights or obligations under that  
 15 contract;

16           2. For rescission of the segOne Contract.  
 17           3. For damages according to proof at the time of trial;  
 18           4. For costs of suit incurred herein, including attorneys' fees;  
 19           5. For such other and further relief as the Court may deem just and  
 20 proper.

21           Dated: May 17, 2006

22           ROBERT M. SCHWARTZ  
 23           MARCUS S. QUINTANILLA  
 24           ANDREW H. HALL  
 25           O'MELVENY & MYERS LLP

26           By: Marcus S. Quintanilla  
 27           Marcus S. Quintanilla  
 28           Attorneys for Plaintiff  
 LA FITNESS INTERNATIONAL, LLC